

# ERF Economic Research Forum POLICY BRIEF

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## Reforming Rules of Origin in Greater Arab Free Trade Area

### for Effective Econom- ic Integration

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#### About the authors

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#### In a nutshell

- Free trade agreements are about reducing tariffs, market access in services, protection of intellectual property rights, streamlining customs procedures, trade remedy measures, and dispute settlement mechanism. Equally important if not even more important than these provisions is the designation of rules of origin. Many benefits can be lost if restrictive rules of origin are incorporated. Rules of origin are supposed to be straightforward and easy-to-follow methods used to determine origin of imported goods. The policy question that arises is how to improve trade integration among Arab countries through more effective rules of origin.
- GAFTA should ease the burden of rules of origin by exempting certain goods from meeting the required rules of origin. The exemption can apply to imported goods that have no tariffs at all or where trivial tariff is imposed. It makes common sense to allow some items certificates of origin to be in English- not 100 percent in Arabic- especially if these items are commonly used.
- For purposes of flexibility and facilitating inter-trade, the validity period for certificates of origin can be expanded to twelve months for instance. GAFTA regulations should allow written advance rulings. Advance ruling allow traders to obtain an origin ruling prior to the importation of a product. Hence, advance ruling saves time and energy.
- Perhaps the most important aspect of GAFTA rules of origin is the dispute settlement process. The dispute settlement process can play a crucial role especially at times when the political will of the integration is questionable. If the dispute settlement body or process is seen independent and able to ascertain its power, this will engender confidence in an integration scheme. There is no public record of origin disputes among GAFTA countries that would shed light on thorny issues. The resulting body of case law can help in interpreting origin rules and remove ambiguities.

### *Impact of Rules of Origin on Trade among GAFTA Countries*

The experience under GAFTA suggests that its goals are being met steadily. However, intra-trade among GAFTA countries is still hovering around 10 percent of the total trade of Arab Countries. These factors range from mere economic factors, such as high level of tariffs and nontariff barriers, trade impediments in some Arab countries, similarity of production structure and traded goods, and lack of adequate transportation infrastructure compounded by distance.

Burdensome ROO is considered as one of the major obstacles that might impede the growth of intra-Arab trade and slow down the process of economic integration by making the costs of compliance higher than the perceived worth of the underlying preference margins.

### *Rules of Origin in GAFTA*

Rules of Origin (ROO) mechanism is used to determine the origin of a product. ROO GAFTA deflects non-partner country goods from profiting from the favorable tariff rates. More than often, ROO are complex and protectionist method used a barrier to trade.

GAFTA includes general rules of origin comprising 13 pages. In addition to the general rules of origin, GAFTA and implementing regulations and decisions includes detailed ROO, which covers approximately 100 pages. GAFTA implementing regulations and decisions provide in exhaustive detail specific ROO for each product which determine the process required of exporters and importers in order to qualify for preferential tariff benefits under GAFTA.

GAFTA adopted several general criteria to determine origin of goods. Based on the current text of GAFTA and its rules, there is no hierarchy in determining what rule of origin comes first when combining more than rule of origin. These rules are:

1) Goods that are wholly produced in one country. Under the “wholly obtained or produced” rule of

origin, in order for a good to qualify for preferential treatment, the product must be “wholly” grown, produced or manufactured in a GAFTA country. Examples for goods that fall under this category include live animals, fish, live trees, and edible fruit and nuts. This rule of origin is straightforward since it does not include materials from third countries and thus does not pose problems.

2) Value-added content which allows for imported goods to receive preferential treatment under GAFTA only if no less than 40% percent of the total product’s value is attributable to production in another Arab country using: “net cost” method, or the “final value of product” method. The “net cost” method aggregates the costs of the various inputs. On the other hand, the “final value of product” method examines value of the finished products.

The “net cost” method requires accurate accounting for input, direct and indirect labor and overhead costs, and other costs. The accounting can be complex. Customs authorities worldwide, including in Arab countries, face difficulties in verifying the value-added of inputs in order to determine preferential treatment. The “final value of product” method is generally simpler for manufacturers, importers and customs officials than calculating “net cost”. With the “final value of product”, only the value of the non-originating imported materials must be calculated. GAFTA authorities may need to do away with the “net cost” method. If this seems not plausible, then the “final value of product” should be used in most cases.

3) Specific criteria such as a change of tariff category test using the Harmonized System nomenclature. This most commonly occurs when a manufacturing process results in a product that is assigned a tariff heading different from the tariff heading of input or materials from outside the region. In other words, a “change in tariff category” rule requires classification of the good in question twice: once on arrival into an Arab country and again on departure from that country. The GAFTA “change of tariff category”

rule is not completely different from the “substantial transformation” rule, i.e. fundamental change in form, appearance, nature “or” character of article which adds to value of article, adopted by some countries like the U.S.

The “change in tariff category” determination requires reviewing the tariff list product-by-product. GAFTA tariff change rule is strict since it requires – in most circumstances- that all of the parts used in manufacturing a product be imported and classified under a different tariff category than the category in which the final product would be classified. In order to facilitate trade, GAFTA “change of tariff category” rule should be relaxed. For example, there could be a de minimis exception, in which parts comprising up to a certain percentage can be classified under the same tariff category of the final product.

4) Certain process requirements for some products allowing certain operations to confer origin. Goods that are subject to this rule of origin include soyabean oil, ground-nut oil, olive oil, palm oil, and sunflower-seed. Although certain process requirements are intended to clarify the value-added determination for particular products, they are often complex. Although certain process requirements are intended to clarify the value-added determination for particular products, they are often complex.

5) Combination of one or more of the above ROO. For example, GAFTA requires some products satisfy the change in tariff heading test as well as contain a minimum level of domestic added value. Examples include organic chemicals and photographic or cinematographic goods. Based on the current text of GAFTA and its rules, there is no hierarchy in determining what rule of origin comes first when combining more than one rule of origin.

#### *ROO for services*

GAFTA does not establish ROO for services. This is a major omission considering that most economies are service-driven. The rationale for establishing ROO

for goods also applies for services. However, the mechanism for determining origin is totally different. For example, while the focus of ROO for goods lies primarily in the manufacturing of the good (for example added-value test), the focus of ROO for services is on the nationality of the service provider. Nationality can be determined by country of nationality for natural person and by ownership or control for companies.

#### *Dispute settlement process*

Any dispute relating to interpretation of ROO or origin verification in GAFTA should be settled bilaterally or if unsuccessful through the Committee on Implementation and Execution or through the Committee of Dispute Settlement. If the dispute settlement body or process is seen independent and able to ascertain its power, this will engender confidence in an integration scheme. For example, in the North American Free Trade Area (NAFTA), panels played an important role in strengthening the free trade area by deciding on disputes between the parties. There is no public record of origin disputes among GAFTA countries that would shed light on thorny issues. The resulting body of case law can help in interpreting origin rules and remove ambiguities.

#### *GAFTA ROO: Gaps between Decisions and Implementation*

Arab countries entered into a new round of negotiations for adopting ROO. By examining the different reports and recommendations issued or made by the League of Arab States (LAS) technical committee for ROO as well as the extraordinary rounds for the Economic and Social Council, Arab countries of GAFTA are in agreement for some ROO. However, there are ongoing negotiations among parties for adopting ROO for some other goods. There are several economic factors that make these goods sensitive from the perspective of some Arab countries: number of economic industries, production volume, level of investment, economic contribution to economy, export value, and use of large number of labor.

There is disagreement among Arab countries on the decision mechanism for adopting ROO. Some Arab countries (Tunisia, Sudan, Algeria, Egypt, Morocco, and Yemen) made reservations concerning adopting a majority voting when approving ROO. Consensus should be used. It is more practical to get the implementation of ROO for those agreed upon items forward regardless of the approval on the remaining list of items. Otherwise, the implementation of ROO for the agreed upon items can be delayed and held hostage for the outcome of negotiations on other items which could take months if not years to conclude.

Examples of gaps between decisions and implementation include observations made among numerous exporters that despite compliance with ROO under GAFTA, companies are not granted preferential treatment and are obliged to pay tariffs. Such decisions are often the result of customs officials' lack of knowledge about the different origin requirements.

#### *GAFTA Certificate of Origin*

The certificate of origin is prepared by the exporter or his representative. However, GAFTA should allow also the producer of the goods to prepare the certificate since the exporter may reasonably rely on the written representation of the producer. It is noted that chambers of commerce are the leading entities for issuing and certifying certificates of origin under GAFTA. Other governmental entities – such as ministry of economy and customs authorities- play less important role. There should a standardized authority in all Arab countries that oversee certificates of origin i.e. chambers of commerce.

The certificate itself is a relatively simple and straightforward document. It contains information relating to the goods in question, producer, exporter, importer, date of manufacturing, final value of the goods, and official stamps. However, the most time consuming part of the certificate of origin requirement is determining how goods qualify for preferential tariff treatment under GAFTA.

A number of countries require the GAFTA certificate

of origin and enclosed bills to be 100% in Arabic. This is a strict interpretation of GAFTA rules. The purpose of strictness is evidently to protect the interests of importing country and prevent concealing fraud. However, it makes common sense to allow some items to be in English especially if these items are commonly used. Trade could not proceed if GAFTA rules are interpreted strictly as there must be a level of good faith and honesty.

The certificate of origin is valid for a six-month period. For purposes of flexibility and facilitating inter-trade, the validity period for certificate of origin can be expanded to twelve months for instance. Moreover, custom authorities in Arab countries should initially afford duty free treatment to shipments of goods accompanied by appropriate certificates of origin. Denial of benefits may occur only after a verification inquiry which determines that GAFTA treatment was unwarranted.

GAFTA does not provide for governmental authorities of one Arab country to make verification into another Arab country's territory. If permitted that may lead to sensitive jurisdictional issues regardless of the fact that such verifications are important. However, as a consequence of this anticipated sensitivity, GAFTA could have provided for a notification and consent process for verifications.

To facilitate trade under GAFTA, Arab custom authorities can indentify certain goods as priorities for verifications. In a step taken to facilitate inter-trade among GAFTA countries, it is acceptable to present a commercial invoice –as long as it is issued in an Arab country- as proof of origin. However, details on the use of commercial invoice as proof of preferential treatment must be spelled out. Also, GAFTA regulations should allow written advance rulings. Advance ruling allow traders to obtain an origin ruling prior to the importation of a product. Hence, advance ruling saves time and energy.

There is a form of leniency for trivial discrepancies in the information contained in the certificate of

origin and accompanied documents. In practice, however, forms are sometimes rejected because of minor mistakes such as typos. It seems that in cases of doubt, the safest course customs official to take is to reject the forms. A distinction must be made between minor and major variations or discrepancies and whether it is material enough to warrant rejection.

### *Conclusion*

GAFTA uses several ROO -such as change in tariff category, value-added, and certain process requirements - to determine origin. These ROO has been confusing to traders, producers, and even lawyers. No single rule used is better than the other. Each origin determination under GAFTA has its own set of advantages and disadvantages. It is noted that there are elements of unpredictability and restrictiveness in each method thus limiting the benefits of tariff reduction or elimination.

Some companies or enterprises in Arab countries may decide to export under the normal MFN tariffs (which can be relatively low) thus foregoing GAFTA benefits. These companies or enterprises – especially small and medium-size companies- are doing so because they believe that their costs of complying with GAFTA requirements, as reflected by change in tariff category, or value content calculations, the anticipated administrative costs of preparing GAFTA documentation such as certificates of origin, and subsequent customs verification, are greater than the import duties that would be saved. These costs may require accounting and customs specialists who small and medium-size companies do not have. This may discourage new exporters and importers from participating in the anticipated benefits of free trade under GAFTA.

Reform of GAFTA ROO is much-needed to facilitate intra-regional trade and economic integration. For instance, rules of origin should as far as possible be based on a sector-by-sector rather than a product-by-product basis. GAFTA should avoid as much as possible multiple specific criteria for one product as this may lead to complexity and confusion. In addition, the “final value of product” should be used in most cases. Certain goods – such as those that have no tariffs at all

or trivial tariff - should be exempted from meeting the required ROO.

There must be a simplification of certificates and forms of origin. There should be improvement in the transparency of official procedures and the response times and fees for all institutions involved in the export and import process. This can be applied by: publishing and updating official deadlines and response times; adopting a tracking system for requests, complaints, and other correspondence; establishing a network for information exchange and coordination; and promotion of electronic filing of documentation.

For less-developed Arab countries, GAFTA should eliminate certification for certain products shipped by those countries. In addition, verification missions should be allowed with proper notification and consent. There must a continuous awareness of ROO among those agents and customs officials who are responsible for implementing GAFTA. ROO should incorporate business and industry perspectives directly into the negotiating rounds. GAFTA should develop a formal dispute settlement mechanism for origin disputes and make it operational.



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